

Untitled

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Re: WESTERN MASSACHUSETTS ELECTRIC COMPANY APPLICATION FOR APPROVAL OF RATE REDUCTION BONDS

D. T. E. 00-40

BRIEF OF THE AGENCIES REGARDING THE
WESTERN MASSACHUSETTS ELECTRIC COMPANY APPLICATION

Introduction

The Massachusetts Development Finance Agency (successor to the Massachusetts Industrial Finance Agency) and Massachusetts Health and Educational Facilities Authority (the "Agencies"), acting jointly, hereby submit the following brief supporting the RRB issuance described in the application (the "Application") of the Western Massachusetts Electric Company (the "Company") to issue Rate Reduction Bonds ("RRBs"). This brief is based on a review of (i) the Company's Application, (ii) the proposed Financing Order, as revised in the Company's submission (the "Proposed Financing Order") and (iii) testimony and responses to information and record requests in the proceeding. It also takes into account information about similar transactions in other states and discussions with three of the principal rating agencies involved in rating such transactions.

Argument

The Agencies recommend approval of the Proposed Financing Order as it relates to matters involving the issuance of the RRBs. (1) The reasons for such recommendation are discussed below.

I. The Role of The Agencies Is to Protect Ratepayers And to Approve Final Terms of The RRBs And The Related Transaction Documents.

A. Protection of Ratepayers.

The Agencies will establish the "financing entity" for the RRBs. In this capacity, the goal of the Agencies is to protect the interests of the Company's ratepayers, who through the payment of the transition charges are the sole source of payment for the RRBs, by:

Untitled

1. Ensuring the lowest all-in cost possible for the RRBs;
2. Streamlining the administrative processes and thereby minimizing the costs of issuing the RRBs; and
3. As provided for in G.L. c.164, § 1H(b)(2), providing expertise to the Department regarding the requirements of the Proposed Financing Order to allow for the most cost efficient structure for the issuance of the RRBs.

B. Approval of Final Terms of RRBs.

The Proposed Financing Order contemplates that the Agencies will oversee the issuance of the RRBs. They will approve the final terms and conditions of the RRBs including structure, pricing, credit enhancement, relevant issuance costs and manner of sale, thereby protecting the interests of the ratepayers. The Agencies and their representatives will also coordinate with the Company the marketing of the RRBs, the procurement of bond trustees and related services, the selection of rating agencies and the underwriting syndicate to minimize the all-in cost of the RRBs and associated administrative expenses.

C. Mechanism to Capture Incidental Benefits for Ratepayers.

The proposed structure includes a Collection Account (consisting of a General Subaccount, a Capital Subaccount, and Overcollateralization Subaccount and a Reserve Subaccount) to account for and credit to ratepayers the incidental benefits received by the Company, should there be any. The Proposed Financing Order ensures that any amounts which represent RTC Charge collections in excess of RRB debt service, fees and expenses and the fully funded credit enhancement reserves, at the time that the Company calculates a periodic RTC Charge adjustment will be incorporated in such adjustment, in accordance with MGL c. 164, §1H(b)(7). The Company has stated in the Proposed Financing Order that it intends to account for, and ultimately credit to ratepayers, any amounts remaining in the Collection Account (other than the Capital Subaccount which is funded at closing by a capital contribution from the Company and an amount equal to interest earnings thereon) after the RRBs are paid in full, such as any overcollateralization amounts, including interest earnings thereon, or RTC Charge collections that remain after the total RRB payment requirements have been discharged. Such amounts will be released to the single purpose entity in accordance with MGL c. 164, §1H(b)(7), upon retirement of the RRBs and discharge of the total RRB payment requirements. The benefits will inure to ratepayers through a credit to their transition charge, or if there is no transition charge, through a credit to other rates. In addition, if the Company, as servicer, is making RTC Charge remittances less frequently than daily, the Company will account for and remit to the trustee for the benefit of the RRB transaction any interest received by the Company on RTC Charge collections while the Company holds such amounts.

II. The Proposed Financing Order Meets The Legal Requirements to Issue RRBs And Contains Provisions Expected to Be Necessary for The RRBs to Achieve The Highest Possible Ratings without Exceeding Published Rating Agency Criteria.

A. Legal Validity.

The Agencies have reviewed the Proposed Financing Order to ensure that it meets the legal requirements to issue RRBs. The Agencies believe these requirements are met.

B. Rating Agency Requirements.

Although it is not possible for the Agencies to compare each requirement of the Proposed Financing Order against a minimum rating agency requirement, because the rating agencies review each transaction in the aggregate, as a collection of legal,

Untitled

Legislative, regulatory, political and credit risks, the Agencies believe that the Proposed Financing Order incorporates all known provisions necessary to achieve the highest possible credit rating and thus the lowest possible interest cost for the RRBs, based on published rating agency criteria and the rating agencies' requirements for the Boston Edison Company ("BECO") transaction, as well as similar transactions in other states. Based on their recent participation in the issuance of BECO's RRBs, the Agencies are not aware of any provision in the Proposed Financing Order that goes beyond that required for the necessary legal opinions or which exceeds the requirements of the rating agencies in the BECO transaction or in rate reduction bond transactions in other states. Notwithstanding the foregoing, the Agencies note that the rating agencies may require a letter of credit to cover the commingling risk for funds collected by the Servicer prior to remittance to the bond trustee. This was not required for BECO, but may be required because of the lower credit rating of the Company. The rating agencies will rely heavily on the irrevocable nature of both the transition property and the Financing Order. Some of the other factors affected by the Proposed Financing Order that the rating agencies will consider are as follows:

1. Automatic True-Up Mechanism.

The true-up mechanism provides a methodology for routine periodic true-ups to occur as required without further Department deliberation, though the Department has at least 15 days to ensure that the methodology was implemented correctly. This meets the rating agency requirement that true-ups be implemented automatically in a timely manner, guaranteeing timely payments to RRB holders. The ability to do additional true-ups if required is also included in the Proposed Financing Order, thereby meeting rating agency requests for the possibility of more frequent than annual true-ups during the time period between expected and legal final maturity of each tranche of RRBs.

2. Credit Criteria for Third-Party Suppliers (TPSs).

The Proposed Financing Order includes criteria for consolidated billing by TPSs that correspond to the published requirements of the rating agencies. The published criteria are as follows:

(i) Minimum Qualification Standard: The Proposed Financing Order requires any TPS rated below 'BBB' to post a cash deposit or comparable security equal to one month's maximum estimated collections if the TPS wishes to bill and collect transition charges. The Agencies believe that this requirement meets known rating agency requirements. At a minimum, rating agencies require a TPS rated less than 'BBB' to post cash or comparable security equal to the number of days between the billing date and the date the Company or successor servicer could assume responsibility for billing in the event of a default by the TPS times one day's maximum estimated collection. Given the Proposed Financing Order's proposed time frame for reversion to dual billing, one month's maximum estimated collections should be sufficient to address rating agency concerns.

(ii) Time Frame for Remittance: The Proposed Financing Order specifies that payments due from ratepayers should be submitted by the TPS to the Company within 15 days of billing, regardless of whether payments have been received by the TPS. Rating agencies suggest this procedure to facilitate tracking of payment delinquencies and ensure a clear definition of payment obligations. For example, if payment is due to the Company within 15 days of receipt by the TPS, the Company cannot determine absolutely that the TPS has met this requirement. If payment is due 15 days after billing, there is an objective standard against which to base compliance.

(iii) Reversion to Dual Billing: If a payment is not made by the TPS within the designated time frame, billing will revert to the Company within seven days. This requirement is consistent with rating agency requirements because it minimizes the potential impact of a TPS default.

(iv) Financial Responsibility: As noted above, a TPS is responsible for remitting

Untitled

transition charges to the Company, regardless of whether the ratepayer has paid. This requirement is consistent with rating agency requirements and will provide an incentive for the TPS to diligently pursue slow paying ratepayers and to manage work-out or default situations.

(v) True-Up Applicability: In the event of a default in the remittance of RTC Charges by a TPS, such amount will be included in the true-up calculation to the extent necessary. This requirement is consistent with rating agency requirements, ensuring that default by a major TPS will not impair the repayment of the securities.

In addition to the foregoing, the rating agencies will consider other factors in assigning a rating to the RRBs. Some of the other factors include requirements such as (i) a bankruptcy-remote special purpose issuer, (ii) overcollateralization, capital accounts, reserve accounts, letters of credit and other structural credit enhancements, (iii) shut-off policies to induce prompt payment from customers and (iv) statutory safeguards, such as the statutory lien on the transition property, the non-bypassability of the transition charges and the Commonwealth's pledge not to impair the RRBs.

C. Proposed Remittance Structure.

The Agencies agree with the proposed process by which the Company will remit to the special purpose entity estimated RTC charge collections based on amounts billed and current cash received and based on a methodology satisfactory to the rating agencies to be designed by the Company.

D. Transition Charge Cap.

M.G.L. c.164, § 1G(e) states that the Department shall set a cap on transition charges that stays in effect until altered by the Department. The Agencies propose that the Department set this cap in the Financing Order to equal the cap as proposed in paragraph 64 of the draft order provisions of the Proposed Financing Order, which provides that it is not subject to reduction.

III. The True-Up Mechanism Proposed by The Company for Increases in The RTC Charge May Require Deferral of Other Charges.

The true-up mechanism proposed by the Company and approved by the Agencies may result in the need for the RTC Charge to increase, requiring flexibility for adjustment to the RTC Charge. The Agencies believe the mechanism proposed by the Company for such adjustments would satisfy the rating agencies and is consistent with the Restructuring Act. The Department may adjust components of the Company's rates and charges by requiring the Company to defer collection of such other rates and charges, at the carrying charge the Department deems appropriate.

IV. Agencies' Review of The Transaction Costs Assure No Double Recovery by Company.

The Company is entitled to recover its initial transaction costs and ongoing transaction costs as set forth in the Restructuring Act, M.G.L. c.164, § 1H(9) including costs of issuing, servicing and retiring RRBs. The Agencies have reviewed the Company's estimates to date, including the proposed administration and servicing fees, and have found them to be reasonable both in terms of the Company's proposed transaction and by reference to the BECO RRB issuance. It is the responsibility of the Agencies to protect the interests of ratepayers, to both assure these costs are reasonable and there is no excess recovery. The Agencies will continue to review the initial transaction costs proposed as part of the principal amount of the RRBs as these costs are finalized at the time of issuance and will monitor the proposed recovery of transaction costs including ongoing transaction costs included in the

Untitled

RTC Charge itself to confirm the Company is not seeking or obtaining a double recovery. DTE will receive information concerning any additional adjustments in the costs as part of the true-up mechanism.

V. DTE Will Periodically Review Financing Orders to Determine If Amount of Reimbursable Transition Costs Amounts Are Accurate.

G.L. c.164, §1G(a)(2) provides that DTE shall review the Company's Financing Order periodically to assure the accuracy of the reimbursable transition costs amounts. If the amount included in the Financing Order exceeds the actual amount of reimbursable transition costs amounts determined following disposition of the assets, then the Company shall provide rate payers with a uniform rate credit based on usage that in total equals the excess including carrying costs. Although §1G(a)(2) also allows the Company to pay the financing entity the excess amount to redeem the RRBs, prior electric rate reduction bond transactions have not included any provision for prepayment or refunding of RRBs because it would cause purchasers of the RRBs to demand compensation for prepayment risk, resulting in higher costs to ratepayers. Therefore, the Agencies agree that the proper mechanism by which to provide ratepayers the benefit is the uniform rate credit, through whatever mechanism the Department and the Company deem appropriate.

VI. The Provision of A Letter of Credit by The Company Will Benefit Ratepayers.

To the extent the rating agencies require the Company, solely because of its current credit rating, to post a letter of credit to achieve an AAA rating on the RRBs, this is a reasonable cost of the transaction. The Agencies approve this reasonable cost as creating a benefit to the ratepayers in enabling the RRBs to achieve an AAA rating and thus the lowest possible interest rate and the Company may recover this cost through the RTC Charge. If, however, the Company proposes a particular practice of collection or remittance to the Bond trustee, such as remitting less frequently than daily, which creates an additional concern or risk to the RRBs for which the rating agencies require a letter of credit to be posted, then the Company should bear the cost of such credit enhancement and such a cost should not be included in the RTC Charge. The Agencies will approve such a structured transaction so long as there are savings to ratepayers.

Conclusion

For the reasons stated above and subject to the limitations expressed in the first paragraph of the Agencies' Argument above, the Agencies believe the Department's approval

of the Company's Application and issuance of the Proposed Financing Order will result in substantial savings to ratepayers not otherwise available.

Respectfully submitted,

MASSACHUSETTS DEVELOPMENT FINANCE AGENCY

MASSACHUSETTS HEALTH AND EDUCATIONAL FACILITIES AUTHORITY

By its attorneys,

Untitled

Maria J. Kroki das
Kroki das & Bl uestei n LLP
141 Tremont Street
Boston, MA 02111-1209
(617) 482-7211
(617) 482-7212 (fax)

Dated: June 30, 2000

1509\0006\90811.4

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

RE: WESTERN MASSACHUSETTS ELECTRIC COMPANY APPLICATION FOR APPROVAL OF RATE
REDUCTION BONDS

D. T. E. 00-40

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing Brief of the Agencies Regarding the Western Massachusetts Electric Company Application upon all parties listed on the attached Service List in accordance with the requirements of 220 C.M.R. § 1.05(1) (Department's Rules of Practice and Procedure).

Dated this 30th day of June, 2000.

Maria J. Kroki das

1509\0006\90811.4

SERVICE LIST

Robert Sydney, Esq.
Division of Energy Resources

70 Franklin St.

7th Floor

Boston, MA 02110-1313

Scott Jordan
Exec. Office of Administration & Finance

State House - Room 373

Boston, MA 02133

John Simon

Exec. Office of Administration & Finance

State House - Room 373

Boston, MA 02133

Mary Beth Gentleman, Esq.
Foley, Hoag & Eliot, LLP

One Post Office Square

Boston, MA 02109-2170

For MassPower

Maria J. Kroki das, Esq.
Kroki das & Bluestein

141 Tremont Street

Boston, MA 02111-1209

For Massachusetts Development Finance Agency and Massachusetts Health & Education Authority

Scott Mueller, Esq.
LeBoeuf, Lamb, Green & MacRae

Untitled

260 Franklin Street

Boston, MA 02110-3173

For Fitchburg Gas & Electric Company

George Dean, Esq.

Assistant Attorney General

Office of the Attorney General

200 Portland Street

4th Floor

Boston, MA 02114

Joseph Rogers, Esq.

Assistant Attorney General

Office of the Attorney General

200 Portland Street

4th Floor

Boston, MA 02114

Andrew Newman, Esq.

Rubin and Rudman

50 Rowes Wharf

Boston, MA 02110-3319

For Western Massachusetts Industrial Consumers Group

Stephen Klionsky, Esq.

Western Massachusetts Electric Company

260 Franklin Street

21st Floor

Boston, MA 02110-3179

Jay E. Gruber

Palmer & Dodge LLP

One Beacon Street

Boston, MA 02108-3190

For Western Massachusetts Electric Company

Janet Zipin

Palmer & Dodge LLP

One Beacon Street

Boston, MA 02108-3190

Unti tled
For Western Massachusetts Electric Company

Jeffrey F. Jones, Esq.

Palmer & Dodge LLP

One Beacon Street

Boston, MA 02108-3190

For Western Massachusetts Electric Company

1509\0006\90811.4

1. 1 The Agencies would note that to the extent that the Proposed Financing Order contains provisions related to any of the following matters, which are properly within the Department's authority, the Agencies make no recommendation: (i) determination and audit of reimbursable transition costs amounts; and (ii) the use of RRB proceeds by the Company.